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C O N F I D E N T I A L SECTION 01 OF 04 BUENOS AIRES 000994

SIPDIS

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TAGS: [EAIR](#) [ECON](#) [EINV](#) [AR](#) [SP](#)

SUBJECT: GOA NATIONALIZES ARGENTINA'S FLAGSHIP AIRLINE

REF: A. (A) BUENOS AIRES 836

[1](#)B. (B) BUENOS AIRES 572

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Classified By: A/Econ Counselor Chris Landberg reasons 1.4(a & d)

SUMMARY

[1](#)1. (SBU) On July 21, Argentina's Minister of Planning Julio De Vido and Secretary of Transport Ricardo Jaime signed an agreement with Marsans, Spanish owner of Argentine flag carrier Aerolineas Argentina (AA) and its sister carrier Austral (together referred to as AA), to transfer management and a full ownership of AA to the GoA. President Cristina Fernandez de Kirchner will reportedly send the agreement to Congress late July 21. Congress must ratify the agreement for it to take effect. The GoA takeover is the latest crisis for the embattled airline, which failed to pay June salaries to its 9,000 employees, has lost US\$260 million since October 2007, and has been plagued by canceled flights and frequent strikes by its union employees. GoA and Marsans officials were blaming each other in early July for the air carrier's difficulties, but have agreed to a settlement. A five-member transition committee will manage daily operations for 60 days while the value of Marsans' equity stake in AA and a final sales price is determined by an outside, impartial auditor. Spanish Vice-President Maria Teresa Fernandez de la Vega, when addressing the agreement, noted that Marsans was "satisfied" and stressed that the GoA had "worked to guarantee that the agreement between the GoA and Marsans contained elements that contributed to the political security" of Argentina. END SUMMARY.

GOA TO TAKE OVER AILING NATIONAL AIR CARRIER

[1](#)2. (SBU) On July 21, Argentina's Minister of Planning Julio De Vido and Secretary of Transport Ricardo Jaime signed an agreement with Marsans, Spanish owner of Argentine flag carrier Aerolineas Argentina (AA) and its sister carrier Austral (together referred to as AA), to transfer management and full ownership of AA to the GoA. Marsans Group is a

Spanish company with various tourism-related interests, including two small Spanish airlines. This follows a July 17 announcement by Secretary Jaime that the transfer would take place, and that the agreement must be ratified by both houses of Congress before taking effect. According to local press, President Cristina Fernandez de Kirchner will send the agreement to Congress late July 21. The GoA and airline staff unions currently hold roughly 5% of AA shares between them, while Marsans holds the remaining 95%. The value of Marsans' equity stake in AA and a final sales price is to be determined by an outside, impartial consultant.

¶13. (SBU) This agreement follows a bruising battle between the GoA and Marsans, played out in local media. The GoA claimed Marsans failed to meet its capital investment and structural reform commitments, which should have enabled AA to turn a profit. Marsans accused AA unions and some GoA officials of actively impeding airline operations with the goal of forcing Marsans to cede control to local interests. On July 15, Secretary Jaime unsuccessfully attempted to force Marsans to sign an agreement acknowledging responsibility for AA's poor financial and operational performance. Prior to the announced agreement, the two parties agreed to eliminate any mention of mutual responsibility.

¶13. (U) According to local media, the GoA and Marsans have agreed to establish a five-member transition committee (three GoA representatives and two from Marsans) that will manage daily operations for 60 days while the firm's value is determined. Julio Alak, current AA Director representing the GoA, will serve as committee President, and Vilma Castillo, the other AA director for the GoA, will accompany him. The third GoA member, an administrative lawyer, will be named on July 21, at the same time that Marsans names their two

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committee members. Secretary Jaime stated that the GoA is taking over AA to "guarantee continued operations and employment," while Marsans says it wants an "acceptable exit without extreme situations." Press reports from July 21 cite government sources saying that the nationalization is temporary, and that AA will be re-privatized when the situation normalizes. But some suspect it may be a longer rather than shorter period of state management.

HISTORY OF LOSSES AND CONTROVERSY

¶14. (C) The GoA nationalization of AA follows the failure of an earlier GoA-coordinated plan to have prominent Argentine ferry transportation entrepreneur Juan Carlos Lopez Mena purchase a controlling stake in AA (Ref B). In mid-May 2008, Lopez Mena and Marsans signed a 60-day "due diligence" agreement during which time Lopez Mena was to examine AA's books and agree on a purchase price. Embassy industry contacts indicate that Lopez Mena pulled back after becoming aware of the magnitude of AA's financial and operational distress. According to Aeropuertos Argentinos 2000 (AA2000) President Ernesto Gutierrez, since October 2007, the poorly run, overstaffed and manifestly inefficient carrier (Ref B) has been losing up to US\$50 million per month. (Local press has reported average monthly losses in the range of \$30 million.)

¶15. (C) Marsans management attributed AA's poor performance and losses to the GoA's delayed and partial implementation of earlier promises to authorize fare increases (even after the GoA allowed two back-to-back fare increases totaling 36% in May and June of 2008, AA's fares remain substantially below those of comparable regional carriers), and expand existing jet fuel subsidies. According to industry contacts, the GoA had also informally agreed to allow the carrier more flexibility in dealing with recalcitrant labor unions and trim down the overstaffed airline (AA has 200 employees per plane, compared to an industry average of 100 per plane).

For their part, Secretary Jaime and the unions accuse Marsans of mismanaging its debts, hollowing out the airline, and reducing its hard assets to a minimum.

¶ 6. (SBU) In fact, AA (not including Austral) has rarely been profitable in its 58-year history, during which it has been nationalized and privatized numerous times (the last time in 1990). Marsans took over ownership of AA in 2001, after a failed privatization to other Spanish owners in 1990. Since, AA has had tumultuous relations with labor unions and GoA officials. According to Jorge Perez Tamayo, President of the Argentine pilots' union, 60% of AA's 57 planes are grounded for lack of parts. Press reports quote Marsans saying that losses of US\$1 million/day began in October 2007 and have totaled about US\$260 million since then. With total earnings of about US\$100 million/month, and total costs in the range of US\$130 million/month, Marsans claims that earlier implementation of the 36% fare increase that the GoA approved in June 2007 would have raised monthly earnings to the range of US\$135 million/month, making the airline profitable.

THE GOA TAKEOVER

¶ 7. (C) The catalyst for the July 17 GoA takeover was AA's failure to pay June salaries to its 9,000 employees and subsequent union service disruptions. In response, the GoA stepped in to pay ARP 50 million (US\$17 million) in back wages, plus ARP 54 million (US\$18 million) to meet current expenses. Spain's Ambassador to Argentina told Ambassador July 10 that Marsans had tried to get additional loans from Argentine-owned private bank Banco Galicia and state-owned Banco de la Nacion to pay June employee salaries, but was told that the Argentine banks could not make the loan and that Marsans should seek financing from Spanish banks.

¶ 8. (U) To force Marsans' hand, in early July Secretary Jaime asked Federal commercial court judge Jorge Sicoli to appoint

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an administrator for AA, who would approve any major company decisions and could negotiate loans from state-owned bank Banco Nacion to pay salaries. Instead of intervening, on July 15 Judge Sicoli requested that the GoA and Marsans try to mediate the dispute themselves. On July 9 Transport Secretariat officials conducted a surprise inspection of AA, after which the inspection team criticized AA as being "acefala," which translates to "leaderless" or "headless." (Marsans owners live in Spain most of the year and their resident Director had been called to the Spain for consultations.) Separately, Ricardo Cirielli, former GoA Undersecretary for Civil Aviation Affairs and current leader of the aircraft mechanics union (APLA), has accused both Marsans and the GoA of fraud and embezzling shareholder funds in 2005 and 2006.

DISAGREEMENT OVER AMOUNT OF DEBT

¶ 9. (C) Recent media reporting on the battle between Secretary Jaime and Marsans over the true market value of AA focused on their widely different claims on AA's debt burden: Marsans claimed it is US\$240 million, while the GoA claimed it is US\$890 million. The US\$650 million difference was due to the GoA and Marsans each using different accounting rules to classify liabilities such as leased planes and legal fees, which, depending on the outcome of future events, may or may not be represent AA debt obligations. According to media reports, in a meeting with Judge Sicoli on July 14, Horacio Fargosi, President of AA, said that the \$240 million figure is the actual debt on which the firm's value should be based.

(AA2000 President Gutierrez, who has been involved in the negotiations, estimates AA's total debt at closer to US\$400 million, including US\$120 million back taxes owed to the GoA, US\$100 million owed to state-owned Banco Nacion, US\$30

million to other private Argentine banks, roughly US\$70-80 million to AA2000, and US\$50-60 owed on aircraft leasing contracts.)

GOS REACTION

10 (U) Although local media reports say Spanish President Jose Luis Rodriguez Zapatero is receiving complaints from business executives of GoA "harassment" of Spanish companies operating in Argentina, the GoS has not actively intervened in the Marsans affair, and public remarks by GoS officials have eased since April. In late April, Spanish Ambassador Rafael Estrella publicly deplored the "campaign of destabilization and harassment" of AA, and warned it could affect bilateral relations and Argentina's image in Europe. GOS Foreign Minister Moratinos also is reported by the press to have expressed his "uneasiness" and "concern" that AA has been taken "hostage" by the unions. On July 11, when asked by the Spanish press about the GoS's opinion of the Marsans affair, Spanish Vice-President Maria Teresa Fernandez de la Vega replied that the situation was a "bilateral issue" that the government was discussing with the GoA and Marsans. On July 14, high ranking sources in the government of Spanish President Zapatero told Argentine media that Marsans wanted "a less traumatic exit". The same day, local Spanish sources told the Ambassador that Secretary Jaime had carried the day in the GoA and the carrier would be nationalized with Spain supporting the best deal possible for Marsans. This culminated with a July 18 press conference in Madrid, where Spanish Vice President Fernandez de la Vega not only noted that Marsans called the agreement "satisfactory," but also said that GoA-GoS relations are "very important" and that the GoS "worked to guarantee that the agreement between the GoA and Marsans contained elements that contributed to the political security" of Argentina.

COMMENT

¶11. (C) It is anybody's guess what will happen once the GoA assumes full control of AA. Possible scenarios include the

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GoA running the airline itself, partially privatizing it through a management contract, or even fully privatizing it -- possibly to a Kirchner-friendly local investor (see Ref A on the GoA efforts to progressively "Argentinize" strategic economic sectors). However, industry insiders (including AA2000 President Gutierrez) speculate that, once the airline is in GoA hands, the unions will work hard to maintain direct government control, since they believe the GoA will be more amenable to their demands. Although AA unions have sought nationalization for years, industry sources agree that national management could lead to a cycle of increasing union demands, and eventually, more strikes, when unions realize that state ownership is not the panacea they hoped for. A history of GoA mismanagement of re-nationalized Argentine firms (Ref A) suggests that the GoA will not efficiently manage AA and that the costs of inefficient management and a bloated workforce will be borne by Argentine tax payers.

¶12. (C) The GoA's heavy-handed intervention in the Marsans affair has dealt a blow to Argentina's bilateral relationship with Spain, Argentina's single largest foreign direct investor. The abrupt GoA takeover of AA will likely discourage future investment in Argentina by the Spanish or, at a minimum, increase the risk premium their companies demand when calculating projected returns on investment. (During the same period, local CGT union forces seeking higher wages smashed doors and windows of a Spanish toll road company in Buenos Aires, complete with anti-Spanish graffiti.) In April the Spanish Ambassador described a "campaign of destabilization and harassment" against AA (Ref

B), subsequently Argentine President Cristina Fernandez de Kirchner discussed the matter with President Zapatero in Lima and she reportedly called him twice shortly before the crisis broke open in July to explain why the GoA felt it had to act.

The recent comments by Spanish Vice President Fernandez de la Vega calling the transfer agreement "satisfactory" suggest that the Spanish government is working to move past this incident, whatever its private irritation.

WAYNE